

Autor: GREGORY S. DAVIS

### **Article for the month: 3**

#### **Companhia Vale do Rio Doce Leads Iron Imports to China**

Companhia Vale do Rio Doce (RIO) became the #1 supplier of iron ore to China in 2006. China's economy grew 10.7% last year and forecasts suggest that its expansion will remain above 10% over the next two years. CVRD has wisely taken a step to hedge its iron ore revenue dependence by becoming one of the largest nickel producers in the world with the successful integration of nickel producer Inco into its organization.

CVRD officially absorbed Canadian based Inco to form CVRD Inco during the 4<sup>th</sup> quarter of 2006. The addition of \$2.8 billion in nickel revenues from Inco helped the new consolidated entity report record revenues of \$20.4 billion up 52% from the previous year. The acquisition of Inco has given CVRD a much needed revenue stream that is not tied to iron ore or other iron related minerals that accounted for 61% or \$12.6 billion of its 2006 revenues.

Two thirds of CVRD's record revenues were driven by price increases for iron ore, copper concentrate and alumina. The average selling price for iron ore in 2006 was \$40 a ton up 22% from the previous year. Price increases are likely to continue to lift CVRD revenues given that a new 9.5% price increase for iron ore was agreed upon by China in December 2006. One third of CVRD's revenue growth was due to an increase in the volume of minerals sold to the Asian market including China, Japan, and South Korea. Germany and the U.S. also remain major customers for CVRD's mineral exports.

CVRD has been able to respond to Asian demand for iron ore and as a result of investments made in previous years to expand its mining capabilities. China imported 30% of the 250 million tons of iron ore CVRD shipped last year which represented a nearly 40% increase from 2005. China was responsible for 18% of CVRD revenues in 2006 up from 15% in 2005. A strong Japanese economy especially during the 4<sup>th</sup> quarter of 2006 also contributed to Asia's growing contribution to CVRD's top line growth. Japan represented 10.8% of CVRD's 2006 revenues up from 9% the previous year.

#### **Brazilian Real Effect**

The appreciation of the Brazilian real against the U.S. dollar was a contributing factor to CVRD's increase in Cost of Goods Sold, but it was still not enough to offset its tremendous upswing in revenues. CVRD gross profit increased 45% from the previous year which helped to push earnings per share up 28% to \$2.69.

#### **Valuation & Competition**

The mining industry is an exciting place to seek out investment returns since the commodities being mined and sold by these companies are not correlated to the performance of the U.S. stock market. Australian mining giant, BHP Billiton (BHP) reported record profits through the end of 2006 while London mining behemoth Rio Tinto (RTP) reported record earnings for the full year 2006. BHP Billiton, Rio Tinto and CVRD all contribute the growth and development of the global economy particularly in Asia as the primary drivers for the record results of each company. Companhia Vale do Rio Doce has the lowest forward price to earnings ratio (P/E) of 9.7 of the three, but I encourage investors to review of all three mining companies mentioned here as each is likely to grow as emerging markets continue to build.

**Author Disclosure:** The author did not own share in any of the stocks mentioned in the article at the time of publication.